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RECENT DEVELOPMENTS ON THE MONETARY FRONT AND THEIR IMPACT ON MONETARY LAW

BY

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Dr. Hirschberg's two books, The Nominalistic Principle (1971) and The Impact of Inflation and Devaluation on Private Legal Obligations (1976) are concerned with a modern legal problem to which far too little attention has been paid.

The author points out in this introductory article that, traditionally, our law has adopted a nominalistic approach in the sense that it has measured obligations, damages, even jurisdiction in monetary terms on the assumption that the nominal value of money will continue to correspond to its purchasing power. Devaluation, monetary instability and inflation have shown this assumption to be incorrect. Especially in relation to long-term obligations, strict nominalism in an age of inflation is an anachronism.

The existing law contains some partial solutions to this problem, but what is necessary is that lawyers should understand the nature and extent of the problem and work out the extent to which a valoristic approach, based on the value of purchasing power of money, ought to replace the traditional nominalistic approach.

MONETARY LAW AND MONETARY PROBLEMS

MONETARY LAW DEFINED

No consensus prevails among legal writers concerning monetary law. Some treat it as an obscure part of commercial law of special and specific interest to bankers and their advisers. Mann¹ and Nussbaum², famous writers on it in Anglo-Saxon countries, treat it as a branch of the law of contracts. In my opinion monetary law is one of the foundations of law. Monetary law regulates rights affected by changes of value of money. As the law uses monetary terms in all its branches - in contracts in statutes, in treaties, in regulations and by-laws, in judgments, in execution, in defining the jurisdiction of the courts, in criminal law, in administrative law, in commercial and taxation law - monetary law has major jurisprudential significance. Law too has its world view, a perfect world according to it is one in which the rule of law prevails and rights are respected. This ideology may be treated as relatively conservative but even today we are not living in a perfect world from

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1. F.A. Mann, *The Legal Aspects of Money*, third edition, Oxford, 1971.
 2. Arthur Nussbaum, *Money in the Law*, Brooklyn, 1950.

this point of view. Justice is expensive and slow, very often frustrated by abuses, i.e. abuses of powers, abuses of rights and abuses of freedom. The proper interpretation of monetary terms has therefore jurisprudential significance having a very important bearing sometimes promoting but very often defeating the aims of justice. However, under monetary stability monetary law has only theoretical significance. Even under monetary stability it should be considered and researched. But under monetary stability it is of interest especially to experts. However, under monetary instability it acquires enormous practical importance. It is of interest to everybody in our society whose rights are affected by its basic approaches and operative rules. As we live in a world in transition, a world which has broken with the past but does not yet know what form the future will assume, in which monetary instability prevails, monetary law at present has jurisprudential significance and its solutions both for the better and for the worse affect very important social, economic, psychological and political institutions of our society. They may contribute to stability and progress but very often magnify instability and institutional decline and breakdown. Its solutions may have far reaching political effects as evidenced by Germany in the post War One period, in the long or short run.

MONETARY LAW AND MODERN REALITY

The law started to develop when the world was created. The study of law acquired a sense of intellectual and social respectability thousands of years ago. However, in the twentieth century a feeling prevails that the law has not adjusted itself to modern reality. Law as a mechanism of defence of our society is weaker than in the past. Law is conservative and very slowly adjusts itself to changing social reality. However, the modern world is very dynamic and modern reality rapidly changes. A maladjustment has therefore developed. This phenomenon may be very easily perceived in the field of monetary law. Monetary law being rigid and based on the nominalistic approach, which provides that a pound is always a pound, developed in the sixteenth and seventeenth centuries under absolutists, monarchs and princes and, bearing still an absolutist imprint, adopts the same solutions (at least in the Anglo-Saxon world) that it adopted in the second half of the nineteenth century, when relative monetary stability prevailed, interrupted shortly by the American Civil War.

CONTEMPORARY MONETARY PROBLEMS

Some maintain that we live in a mad world. However, there is an inner logic in its madness. The present world operates according to its own rules of logic even though these rules are far removed from conventional wisdom and logic. Our world is a world in transition. In the opinion of sociologists the basic trend all over the world is from traditional to rational. However, not everything that is traditional is by itself irrational and not everything which is treated as rational is rational within its deeper meaning and in the long run. We are destroying through adopting seemingly rational approaches very important and valuable institutions which are traditional.

When monetary stability ceased to be an article of faith for monetary authorities, and when carrying out a devaluation ceased to be an admission of commercial and moral bankruptcy, the dam was breached and monetary instability ensued. However, there is some justification for the modern approach that in the scale of values and rules of behaviour of policy makers monetary stability is treated as less important than growth and full employment and is very often sacrificed for the sake of achievement of other objectives of public policy. We must run because we cannot afford to stand still. The whole modern development is overshadowed by Keynes and Marx. We live in an era of competition between the systems, the capitalistic and the socialistic. We live in an era of welfare states. The modern reasonable man is impatient and spoilt. He is better educated than his forefathers and much more sensitive. He tends to blame the government for everything that goes wrong. He does not tolerate unemployment and economic depression, but neither is inflation popular with him. He wants to live in a perfect world. But our world is imperfect and it can become more perfect only through gradual development and slow evolution. However, many of our institutions are maladjusted to modern reality and they must be reformed quickly otherwise they will contribute to instability and to crises. Once monetary instability started, both from below and from above, unreformed monetary law has become a historical anachronism. As it is rigid and maladjusted to modern requirements it does not contribute to our ability to cope with crises. In an article written on 15.11.71³ I predicted that many monetary crises will happen in the present world. This prediction was justified by subsequent events at least till the end of 1975. No serious attempt was made lately to reform monetary law notwithstanding the magnitude of monetary crises. Even no intellectual reform was carried out, change of attitude to monetary law, in the light of monetary instability. We can afford many luxuries in the modern world, the luxury of not thinking on comparative problems is not one of them. Lawyers must think about the attitude of law to contemporary problems. In a rapidly changing world we must constantly readjust to rapidly changing reality. We must revise our concepts and approaches as a condition precedent for reforming our institutions. An unthinking world is a foredoomed world. Intellectual effort in the long and short run may save the modern civilisation from destruction and anarchy. All the above has both general and specific application. Institutional breakdown caused World War Two, institutional breakdown in our era may contribute to or cause many crises. Institutional decline and breakdown may be prevented only by intellectual effort and by giving effect in practice to new approaches developed by it.

MONETARY PROBLEMS UP TO 1967

MONETARY PROBLEMS IN HISTORY

Monetary problems have always been the result of economic, social

3. See E. Hirschberg, "Monetary Law and Contemporary Problems" *Estudios de Derecho*, No. 82, September 1972, p. 363.

and political instability. Solon the Greek is believed to have been the first statesman to carry out a devaluation of currency. During the period of fifty emperors in the third century A.D. in Rome, monetary instability prevailed, as the currency was continually debased. During the middle ages monetary problems and crises often happened. In the U.S.A. during the liberation war "continentals", paper money issued by the Continental Congress, almost lost their value.⁴ "Assignats", paper money issued by the French revolutionary government during the French revolution, lost their value. The import of gold from the New World to Spain and Portugal decreased the value of precious metals and therefore money.

MONETARY INSTABILITY SINCE THE END OF THE FIRST WORLD WAR

From 1918 till World War Two monetary instability assumed modern dimensions. The economy became monetary economy. Monetary economy replaced subsistence economy almost all over the world. Almost everywhere the internal gold standard was abandoned. Immediately after the first world war grave monetary crises erupted in Germany, Austria and Russia, and other East and Central European countries. The great German inflation in 1920-24 caused a complete ruin of currency and the middle class and paved the way, in the opinion of eminent historians, for Hitler and all that followed. During the economic crisis which was caused by the Wall Street crash in 1929, many competitive devaluations were carried out.

MONETARY INSTABILITY SINCE 1945

Since the end of World War Two monetary instability has prevailed both in developed and underdeveloped countries. The difference was of degree and not of kind. The reason for this was Keynesianism, namely the attempt to implement Keynes's⁵ ideas in practice, in developed countries, i.e. the attempt to induce growth and full employment. Instability of value of money was treated as the lesser evil and policy-makers were ready to sacrifice monetary stability for the sake of achievement of growth and full employment. Hundreds of devaluations were carried out all over the world in this period. In underdeveloped countries monetary instability was caused by the quest for development and bridging the gap between the underdeveloped countries and the developed countries. In Brazil under Kubitchek an attempt was made to achieve fifty years growth during five years. The result was rapid inflation. In Israel the value of the Israeli pound had preserved by the end of 1967 only one-fourteenth of its value in comparison with 1948.

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4. See E.L. Hargreaves, *Restoring Currency Standards*, London, 1928.
 5. J.M. Keynes, *The General Theory of Employment Interest and Money*, London, 1936.

MONETARY INSTABILITY SINCE 1967

On 18th November 1967 the pound sterling was devalued. The devaluation of sterling was followed by many devaluations in many countries. Since then the two major reserve currencies in the world, the pound and the dollar, are in trouble. The dollar was devalued twice, on 18th December 1971 and on 12th February 1973. The Bretton Woods system established by the International Monetary Fund based on fixed parities between the different currencies whose mainstay was the dollar has broken down and a system of floating of the major currencies has replaced the system of fixed parities. The year 1967 may be termed the turning point on the monetary front. Since then monetary instability to a higher degree than formerly prevails. The years 1973, 1974 were years of world wide inflation. In the first quarter of 1974 and in 1975 a world wide recession has prevailed but inflation has continued. In 1975 stag-inflation, stagnation during inflation has prevailed. In Israel from 10th November 1974 till August 1976 many devaluations were carried out, many minor, creeping devaluations and two major whose combined effect was to reduce the value of the Israeli pound by almost one hundred percent in comparison with the dollar, from 4,20 Israeli pounds to a dollar to 8,12 Israeli pounds to a dollar. In Argentina the position was much worse. In 1975 there was an inflation of 350% a year. In Chile a very rapid inflation has prevailed since Allende times.

THE OUTLOOK FOR THE FUTURE

The major problems which have caused the monetary instability since 1945 are still with us. They have not yet been solved. A conflict between the haves and the have nots prevails both internally and externally. The underdeveloped countries, as evidenced by the oil crisis, desire a larger stake in the world's prosperity. On the internal front the less painful way to reduce poverty and inequality of wealth and income is through growth and full employment.

We may succeed in our fight against inflation but world prosperity may be sacrificed. The foundations of world prosperity are anyhow shaky at present. World prosperity in the post World War Two period was brought about by the economic optimism of consumers and producers and by government intervention in the economy. This basic optimism of the consumer is much weaker at present than formerly, but his optimism is the foundation of world prosperity. Governments are often prevented from timely intervention in the economy by resistance to and fear of inflation. The buoyancy of demand in the post World War Two era was caused by constant redefinition of the scale of economic values, with luxuries becoming necessities. This process has continued for so long that it may be reversed. The demand for durable consumers goods in 1974 and 1975 in the U.S.A. was rather weak and has caused the recession. No trend persists forever without interruptions and reversals. Attempts to fight inflation in the present setup may produce the effect that we shall have instead of prosperity without inflation, inflation without prosperity.

The underdeveloped world must overcome its problems of underdevelopment. Otherwise the system will be endangered. But economic, social and political dynamism is almost always synonymous with inflation.

But even if world prosperity will cease, monetary prosperity will probably continue to be with us. Policymakers will not accept economic stagnation and crisis either of their own volition or through the activities of two large pressure groups, the businessmen and trade unions and aroused public opinion. They will attempt to overcome it and monetary problems will ensue.

Whatever the outlook for world prosperity and world stability the outlook for monetary stability is not encouraging. Monetary problems will probably stay with us for many years. We have to accept this fact and change our attitude to monetary law which is the legal dimension of monetary problems. The attitude to monetary law must be influenced by our approach to contemporary problems. Monetary problems affect private rights and cause an enormous redistribution of purchasing power between creditors and debtors and class and class through the channels of monetary law, especially through the medium of the nominalistic principle.

MONETARY LAW IN THE LIGHT OF CONTEMPORARY MONETARY PROBLEMS

NOMINALISM

In my book⁶ the whole theoretical approach of nominalism is discussed. From the theoretical point of view its foundations are shaky. Further it is maladjusted to contemporary monetary reality. This approach is responsible every year even during mild inflation for transference of purchasing power to the tune of tens of billions of dollars. This approach is traditional, if the modern trend is from traditional to rational it must be reformed and adjusted to modern reality. At present the whole body of existing monetary law almost all over the world is based and organized around the nominalistic principle. Existing monetary law should be reformed, it must be organized around some compromise between the nominalistic and the valoristic, i.e. purchasing power approach, especially but not exclusively as regards long term obligations. However, the practical reform is very difficult to be effected in practice. A great deal of discussion on the academic level is a condition precedent for reform. The road to reform is a roundabout way through professional opinion, i.e. lawyers, economists, businessmen and well educated members of the public. There is a need of reform but there is no will to carry it out. There are problems at present but there are no solutions. The will to effect a reform of monetary law must be created through dissemination of knowledge and provoking of thought. This was the aim of *The Nominalistic Principle*. Change of attitude, i.e. intellectual reform, is a condition precedent for practical reform of the whole body of monetary law.

6. E. Hirschberg, *The Nominalistic Principle, a legal approach to inflation and devaluation*, 1971, Bar Ilan University, Ramat Gan, Israel.

PRACTICAL PROBLEMS OF NOMINALISM

The most important problem is the fate of long term obligations. A great part of national wealth is held in a liquid form in developed economies. Long term obligations like mortgages, bonds, life insurance, pensions, social security are defined under nominalism in monetary terms and therefore lose part, and sometimes the major part, of their value over a long period of years - or at least this has been the position till now since the end of World War One. One possible solution is to adopt the valoristic solution to long term obligations for the duration of ten years and more. According to this approach the assumption of risks concerning the value of money would pass from the creditor to the debtor. In the long term obligations the obligation would be not to repay a nominal sum of monetary units but the real value of such obligation at the time that the obligation was incurred, as measured for instance by the cost of living index.

Another problem is the fate of a debt not paid in due time as provided by the contract. Under rapid inflation there is an incentive to postpone payment of debts and obligations. In my book *The Impact of Inflation and Devaluation on Private Legal Obligations*⁷ the whole problem is discussed at length. Partial solutions in the form of damages for delayed payment are available in the Anglo-Saxon legal systems. These solutions must be further extended. The practical justification for nominalism is the assumption of risks. However, the creditor according to this approach has assumed the risk for the duration of the contract and not beyond it, therefore at the date of payment provided by the contract the risk of change of value of money should pass from the creditor to the debtor.

Another problem is the problem of frustration of bilateral executory contracts for future performance. Again this problem is discussed at length in my book *The Impact of Inflation and Devaluation on Private Legal Obligations*. It is probably possible according to the doctrine of implied terms to claim that a sudden devaluation and an unexpected inflation have frustrated such a contract. This solution for which still no firm authorities exist must be implemented in practice and further extended. National currency in a contract serves as a standard of value. If its value depreciates this is a problem outside normal commercial risk taking. In assessment of damages for breach of contract and in torts the approach must be adopted, which is even now partly given effect to in practice, that the party claiming damages is entitled to *restitutio in integrum* in the real value of money.

These are only some of the problems which require change of attitude and solution. Strict nominalism in an inflationary era is an anachronism. It is neither just nor effective in the long run. Law does not operate in a vacuum. It must adjust itself to solution of problems created by an era of instability of value of money. Under

7. Bar Ilan University, Ramat Gan, Israel, 1976.

nominalism changes of value of money are not taken into account when the extent of a monetary obligation is ascertained. Each practising lawyer in his daily practice comes into contact with problems created by monetary instability. He is usually aware of the problems but does not know what are the solutions. Therefore he only partially performs his duty towards his clients mainly because he is uninformed. Some partial solutions are available within the field of existing law as discussed at length in my book.⁸

VALORISM

From the theoretical point of view, valorism is much sounder than nominalism. It is the perfect approach for the perfect world from the point of view of the law, i.e. a world based on the rule of law and respect for rights. At present even relatively normal times are treated as inflationary from the point of view of nineteenth century stability. Therefore monetary law should be based on some compromise between the nominalistic and valoristic approaches. Value clauses which give effect to the valoristic approach by agreement should be upheld. They provide a legitimate avenue of escape at present. Legal opinion which is at present very sensitive about direct interference with rights should react to indirect interference with rights through the medium of the nominalistic principle. Nominalism and valorism should become the object of legal and economic study, contemplation and research. Monetary law can continue in its present unreformed state for long only at our peril. Nominalism may under severe inflation affect the whole law and order in the economic and commercial field and detract from the respect due to law and the legal profession. The aroused man in the street will not tolerate for long, under severe inflation, the continued rule of nominalism. The man in the street, the reasonable man, in our time is a valorist, he is interested in purchasing power even to the extent that, so long as inflation does not reach a certain degree, he is not very interested in legal niceties. A clash of approaches between the reasonable man and the existing law exists already. It may be further aggravated by the aggravation of inflation.

When inflation becomes very severe, let us say more than 50% a year, the valoristic approach should be adopted and nominalism be deviated from even in case of medium term obligations, and many short term obligations. In 1974 the inflation in Israel reached 56%. Many factors have caused this inflation and especially the after effects of the Yom Kippur War. In emergencies such inflation is possible in many countries.

Further, obligations like alimony or annuities should be treated as valoristic obligations. Up to a point they are treated as such even at present. But a general rule should be adopted that they must be treated as valoristic obligations. Even in the fields where the

8. *The Impact of Inflation and Devaluation on Private Legal Obligations*, Bar Ilan University, Ramat Gan, Israel, 1976.

existing law adopts the purchasing power approach, like in torts and claims for alimony, theoretical discussion is necessary as the novel approach must be based on more firm foundations. Monetary law under instability of value of money is one of the most important parts of modern jurisprudence.

REVALUATION

A whole chapter was dedicated in my book *The Nominalistic Principle*⁹ to the analysis of German revaluation and the revaluation carried out in the Southern States of the United States. This was done not only owing to historical reasons. These revaluations should serve as models for revaluations which should be carried out in Israel and Latin American states like, for instance, Chile after a rapid inflation. German inflation was one of the reasons for Hitler's ascent to power. Modern rapid inflations may serve as one of the reasons for totalitarian revolution from the left or the right. They destroy and ruin the middle classes which are the most stable politically. It is true that the German revaluation was carried out under extreme circumstances. The reasonable man at present is much more sensitive to interference with rights than his forefathers. Even an inflation of two hundred percent during several years should be treated now as very serious. This monetary instability and crises are responsible for loss of social and economic standing of the middle class. It may sit on the sidelines in case of political upheaval as a result of this unless timely revaluation intended to restore rights destroyed and undermined by inflation is carried out. The German revaluation was too little and too late. At present lessons must be drawn from historical experiences. Circumstances are different in many places of the world, but human nature is similar. Whatever is not just and affects large segments of the public at present is in the long run not effective too. Crimes of omission through ignorance and superficial and conventional approaches may have very serious and far reaching consequences in the short and long run. Rapid inflations have happened in Latin American countries in recent times and may and probably will happen in the future. Things very easily get out of control in times of political, economic and social turmoil as happened under Allende in Chile and may happen elsewhere. A timely and adequate revaluation of obligations is a partial solution intended to restore the equilibrium destroyed by inflation. We should always remember Santayana's warning that those who do not learn from history are fated to relive it. Crises in the present set-up are very dangerous. They may be responsible in extreme circumstances for the destruction of our whole civilization. The world at present is full of dormant and half active volcanoes. They may erupt and bury many important values under the debris through their eruptions. Crises must be prevented, alleviated or at least minimized at the present set-up. We cannot afford the luxury of having too many of them. We live in an imperfect world. We cannot make it perfect in the short run, but we can make it less imperfect. Revaluation of obligations is a practical remedy at present

9. Bar Ilan University, Ramat Gan, Israel.

times and not only of interest to economic and legal historians especially but not exclusively in Latin American countries.

CONCLUSIONS

As a result of the adoption of new approaches on public policy, i.e. that growth and full employment and development are more important than monetary stability, a new inflationary era started all over the world both in the developed and underdeveloped countries.

Monetary problems at present are the almost necessary incident of present dynamism, political, social and economic which prevails all over the world.

It seems that monetary problems will continue to prevail in the future. Monetary law is the legal dimension of monetary problems. Its basic principles and the whole body of operative rules is at present maladjusted to modern requirements. It must be reformed. However a condition precedent for such reform is change of attitude to its basic principles and its theoretical foundations. An intellectual reform must precede practical reforms. The aim of my books and articles is to disseminate knowledge and provoke thought on the basic principles of monetary law and its practical remedies used in history, like the revaluation of obligations, which should be applied in practice in the present and in the future in certain countries. My books are a product of pioneering effort carried out under difficult conditions as no facilities for its carrying out were available. At present a great deal of institutional and psychological rigidity prevails which makes it difficult to study and research monetary law. This psychological and institutional rigidity must be breached. The present state of monetary law, so long as it is not reformed, is and will probably be responsible for many and possibly very severe crises. We are in a quite late stage in our attempt to change the attitude of professional opinion to monetary law in view of the severity of monetary crises at present and in the recent past. But better late than never. We must continue in our quest for a greater degree of justice and social effectiveness.

" . . . so the total fine will be \$23 000."

"Will your Lordship give me time to pay?"

"That seems a reasonable request. How long do you require?"

"Until the bank opens tomorrow morning."



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